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Research paper

Earning Management and Risk Profile in the Banking Industry: Case Study from Indonesia

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Abstract

This study aims to investigate the application of earnings management and risk profile in the banking industry in Indonesia, during the period 2008-2017 data on 41 banks listed on the Stock Exchange. This research use analysis technique of FMOLS regression data by first doing correlation test by using correlogram. From the research that has been conducted in the results that there is a very significant relationship between earnings management and risk profile in 41 banks in Indonesia.

Keywords: *Earnings management, risk profile, FMOLS regression.*

1. Preliminary

In a Securities and Exchange Commission (SEC) report a fantastic fine, amounting to US $ 29.2 million to a well-known Halliburton company in violation of corrupt practices or the Foreign Corrupt Practices Act (FCPA). In the lyrical SEC report, explained that the Halliburton company earned only US $ 14 million in profits from a business deal considered to violate FCPA. Thus, this fantastic side is worth the error: Halliburton belongs to a leading multinational company that deserves business ethics and legislation. Especially in the United States apply SOX, FCPA, and other regulations and become a role model of management practices. Halliburton as a large corporation should have and implement anti-fraud governance in which it is fraud risk management and fraud control.

The fine for Halliburton is related to Halliburton obtaining business by paying corruptive payments to get oil service contracts to Angola state-owned company named SONANGOL. In addition to a $ 29.2 million fine, the Halliburton Company is also required to obtain an independent consultant who will review and oversee the anti-corruption policies of Halliburton for at least 18 months, then Halliburton Vice president Jeannot Lorenz fined USD75,000 for FCPA violations, internal accounting control and falsify bookkeeping and records. The case of Halliburton's position according to the SEC begins with Halliburton's efforts to maintain a local company in Angola owned by former Halliburton employees who became comrades and neighbors of the SONANGOL official who finally approved the contract. Halliburton made a $ 13 million contract to a local company to comply with local content provisions, not for the scope of work. Lorenz should have left the scope of the contract and searched for the right contractor.

In this mismanaged corporate governance practice, Lorenz failed to execute a competitive tender, avoiding the obligation to request a review of a procurement contract to a local company first to a special committee at Halliburton. Halliburton paid US $ 3.705 million to a local Angola company and finally awarded Halliburton the seven contracts. Learning from this case, Halliburton appears to have internal rules and controls to prevent corrupt practices regarding obtaining contracts and subcontracting. However Halliburton failed in its implementation resulting in reputational risk and compliance risk. The profit earned is eroded by a fine. Internal auditors in assurance of the earnings (sales) or business acquisition cycle must be aware of fraud risks. Similarly, in conducting assurance on the procurement cycle (purchase) internal auditors should be wary of fraud risks. This obligation has been determined by the internal audit standards issued by the Insititute of Internal Auditors (IIA).

Is there a link between earnings management and risk management in corporate management. Therefore, the authors are interested to do this research, with the theme of earnings management and risk profile of the company, in view of the banking industry. The authors highlight this theme, as it sees the banking industry in Indonesia as being vulnerable to earnings management and risk profile.

2. Literature Review

In this study the theme of profit management and risk profile in banking companies in Indonesia. The research done by this writer is almost the same as the study done by [1] in banking companies in Brazil. However, research conducted by [1] uses data on financial statements that range between 2001 and 2012 in Brazil. Seeing the importance of banking in the economy in a country, it is necessary to do similar research in Indonesia country. In a study conducted by [1] looking at how discretionary accrual factors are found in financial funds, they are used as analytical tools developed by using profitability ratios from banking in doing research. In earnings management, the role of a manager in the banking industry uses a model discretionary accrual accounting, which can directly create legal and illegal practices, when viewed from the accounting side. But this practice of earnings management, making the role of agents can influence the perception of risk and business analysts of the company as a whole. As described in paragraph 1, a study conducted by [1] in Brazil, gives results that banks in Brazilian countries practice earnings management. What is the hypothesis that has been built in the research, do the test using 2SLS method and give significant results, for the hypothesis that is made. The first conclusion

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explains that in brazil, largely has the potential to avoid taxes by doing EBIT calculations, which are pre-deducted and pre-taxed. Furthermore banking in Brazil also seeks to avoid taxation, by means of EBIT calculations relating to previous periods. This does not coincide with research that has been done before by [2]. But in general there is no clarity as to whether or not brazil is trying to avoid taxation by calculating EBIT earnings in relation to the previous period, occurred in the group of banks that have upper middle category.

But certainly, their studies have contributed to the identification of a practice of earnings management in the banking industry, and such studies have not been done in Brazil before. By referring to the studies already undertaken by [1 & 2] asserting that, for earnings management practice has its own distinctive characteristic for each State. With different analysis models and sample studies, but still for the banking industry, with different research sites. In the banking system used by the German state for example, it certainly can not be applied to a country like Brazil. If in German banking there is a lot of avoidance by showing net income which tend to be minus, inversely for the profit earned when compared with the previous period. The same study result is also done by [3 & 4], still review about earnings management practice, but focusing on public sector companies. In [4] for example, notes that the outcomes [1,2 & 3] apply to [4] which is more in the process of rigorous evaluation of parties such as regulators and investors. To date, with the research that has been done, little attention is paid to the occurrence and application of earnings management practices in the banking sector, for further analysis. [5 & 6] Still in the context of earnings management, the purpose of this study is to create transparency in the banking industry especially in Indonesia, which is related to the process of giving financial statement information to the users or users of the financial statements. Some earnings management practices such as presenting a balance sheet tend to overload assets, and displaying loans to creditors and investors lower, as well as lending to large customers for the banking industry. This can indirectly create uncontrolled earnings management practices.

3. Research Methodology

This research was conducted in March 2018, using the data of banking financial statements registered during the period of 2008-2017. In this study using correlation data analysis techniques and offer extensions of the Phillips and Hansen (1990) [5] fully modified OLS estimators to panel settings [7,8,9 & 10]. Variables in this study consisted of variable earnings management and risk profile variables. Variable earnings management variable over CFO (it) / Tait-1, DISEXPit / TAit-1, EARNING, and risk profile variables NPL, ROA.

4. Research Results and Discussion

Table 1: Result for Correlation Analysis

Sample: 1 401						
Included observations: 400						
Autocorrelation	**Partial Correlation**		**AC**	**PAC**	**Q-Stat**	**Prob***
.|*** |	.|*** |	1	0.414	0.414	69.137	0.000
.|** |	.|* |	2	0.294	0.148	104.12	0.000
.|* |	.|. |	3	0.158	-0.008	114.28	0.000
.|* |	.|. |	4	0.130	0.041	121.13	0.000
.|. |	.|. |	5	0.034	-0.056	121.59	0.000
.|. |	.|. |	6	0.013	-0.012	121.66	0.000
.|. |	.|. |	7	0.019	0.028	121.82	0.000
.|. |	.|. |	8	0.031	0.023	122.21	0.000
.|. |	.|. |	9	0.062	0.053	123.80	0.000
.|. |	.|. |	10	0.031	-0.019	124.20	0.000
*Probabilities may not be valid for this equation specification.						

Source: Proceed author by STATA

From table 1 above, it can be seen how The correlogram has spikes at lags up to three and at lag ten. The Q-statistics are significant at all lags, indicating significant serial correlation in the residuals. The conclusion that can be taken for table 1 is the significant correlation to the variables in doing the research. This test is continued with the FMOLS model in multiple regression, as presented in table 2 below.

Table 2: Result for FMOLS Model Analysis

Dependent Variable: DISEXPIT_TAIT_1				
Method: Fully Modified Least Squares (FMOLS)				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
EARNING	0.138036	0.033503	4.120141	0.0000
ROA	0.207149	0.067861	3.052545	0.0024
X1_EARNING_MANAGEMENT_CF	0.367120	0.095182	3.857019	0.0001
X2_RISK_PROFILE_NPL	0.160375	0.074194	2.161553	0.0313
C	0.105799	0.032362	3.269257	0.0012
R-squared	0.192354	Mean dependent var		0.281706
Adjusted R-squared	0.184175	S.D. dependent var		0.291734
S.E. of regression	0.263503	Sum squared resid		27.42632
Durbin-Watson stat	1.170198	Long-run variance		0.172135

Source: Proceed author by STATA

At the top, there is table 2 that has a dialog and displays the estimation methods and information about the samples used in the estimation.

Just below the sample information, STATA indicates that the estimates are based on combined estimates only by using cross section trend constants. Covariance coefficients are calculated using default settings, and long-term covarians use the Bartlett kernel with user-specified bandwidth.

The middle section shows the approximate coefficients, standard errors, and t-statistics, which differ slightly from the results for the CFO (it) / Tait-1, DISEXPit / TAit-1, EARNING, NPL, ROA variables. The coefficient value is statistically significant. The bottom of the output shows various summary statistics. Notice in particular, the reported "long-range variant" variant, which shows the estimated long-term average variance by condition, is derived from DOLS residues. [12]

The square root of this variance, 0.192, is somewhat higher than "S.E of the regression value" 0.184, which is based on the usual estimator of the residual variance.

The results of table 2 are described in terms of the regression equation listed below:

Table 3: Result for Estimation Command Analysis

Estimation Command:
COINTREG DISEXPIT_TAIT_1 EARNING ROA X1_EARNING_MANAGEMENT_CF X2_RISK_PROFILE_NPL
Estimation Equation:
DISEXPIT_TAIT_1 = C(1)*EARNING + C(2)*ROA + C(3)*X1_EARNING_MANAGEMENT_CF + C(4)*X2_RISK_PROFILE_NPL + C(5)
Substituted Coefficients:
DISEXPIT_TAIT_1 = 0.138036317104*EARNING + 0.207148942033*ROA + 0.36711978458*X1_EARNING_MANAGEMENT_CF + 0.160375194532*X2_RISK_PROFILE_NPL + 0.105798859375

Source: Proceed author by STATA

If you look at the dialog box, there is a positive relationship between the variables in doing the research thoroughly. In the sense that, if the value of TAIT is positive, then there is a tendency for EARNING, ROA, EARNING MANAGEMENT, NPL is also positive. Vice versa, if the TAIT value is negative then, for other variables will tend to follow the distribution of the number of equations generated.[13]

5. Conclusion

By making a flashback in 1987, earnings management has emerged as a discussion and something to debate today. How the practice, the disclosure and explanations and methods used in various kinds. To date, earnings management is still considered a clear topic and a little difficult to explain in accounting theory. To conduct a management of earnings management in a company, it is considered not so simple and difficult, this quote considers that earnings management practice is defined as a policy tool within the management of a company that deals with the use and selection of accounting methods in financial reporting, but earnings management in conception can make the process of wealth transfer economically. This research has a theme about earnings management which is connected with risk profile in company. Thus, the role of managers in the application of earnings management, at enormous value.

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